



MODERN MARKETS  
INITIATIVE

May 6, 2021

**By electronic mail to rule-comments@sec.gov**

Vanessa Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-0609

**Re: Notice of Filing of Amendment to the National Market System Plan Governing the Consolidated Audit Trail by BOX Exchange LLC; Cboe BYX Exchange, Inc., Cboe BZX Exchange, Inc., Cboe EDGA Exchange, Inc., Cboe EDGX Exchange, Inc., Cboe C2 Exchange, Inc. and Cboe Exchange, Inc., Financial Industry Regulatory Authority, Inc., Investors Exchange LLC, Long- Term Stock Exchange, Inc., Miami International Securities Exchange LLC, MEMX, LLC, MIAX Emerald, LLC, MIAX PEARL, LLC, Nasdaq BX, Inc., Nasdaq GEMX, LLC, Nasdaq ISE, LLC, Nasdaq MRX, LLC, Nasdaq PHLX LLC, The NASDAQ Stock Market LLC; and New York Stock Exchange LLC, NYSE American LLC, NYSE Arca, Inc., NYSE Chicago, Inc., and NYSE National, Inc. (File No. 4-698)**

Dear Ms. Countryman:

Modern Markets Initiative (“MMI”), the education and advocacy association devoted to the role of technological innovation in creating the world’s best markets, appreciates the opportunity to provide written comments to the SEC in connection with the recent “Joint Industry Plan; Notice of Filing of Amendment to the National Market System Plan Governing the Consolidated Audit Trail” (the “Proposed Funding Model”).<sup>1</sup>

MMI stands in broad support of global regulatory efforts to establish holistic, cost-efficient and data-driven policies to best ensure the stability of the markets for all participants, and in favor of tools such as the Consolidated Audit Trail (CAT) for surveillance of the integrity of the markets to ensure secure savings and investment and investor confidence in the markets. Our members have supported the idea of the CAT, and worked to support the build process since the beginning - believing that the CAT would provide better regulation, more efficiently, than legacy processes.

## **I. Introduction**

The “Proposed Funding Model” was the first disclosure of the enormous and unexpected Historical Costs for the CAT. The \$242 million spent to date (per the filing) is roughly five times more

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<sup>1</sup> “[Joint Industry Plan; Notice of Filing of Amendment to the National Market System Plan Governing the Consolidated Audit Trail.](#)” 86 FR 21050; Release No. 34-91555 File No. 4-698; 2021-08049 (April 21, 2021).

than the highest estimated cost cited in the 2014 filing.<sup>2</sup> This leads to a number of important questions we respectfully ask the Commission to consider and address, among other things:

- A. What was the business rationale that a small number of brokers should pay the vast majority of the now-inflated cost without having any insight or authority into the methodology and rationale for the cost? There seems no doubt that they are being asked to pay for something “sight unseen.”
- B. What precedent is the SEC using for this approach?
- C. How did the cost for the project increase by five times – is there a blank check for the project?
- D. What more is the CAT project getting for the five-fold increase in spending? Is there a corresponding benefit?
- E. What improvements will be made in the communications process to ensure that stakeholders can monitor progress and failure?
- F. What indicators and metrics should be used to provide for accountability on cost-effectiveness and timeliness of performance?
- G. What further transparency can be provided around message traffic input by product type and participant type (on vs. off-exchange) to the CAT?

Further, looking forward, the “Proposed Funding Model” presents a cost-sharing structure with some very concerning holes around transparency on pricing, how cost allocation was arrived at, distributions of cost between SROs and brokers, and questions regarding equitable funding among market participants.

## **II. Next Steps – Proposed Action Items**

For the reasons further discussed below, MMI respectfully urges that SEC should compel:

- A. The exchanges and FINRA to re-issue the cost sharing structure, considering the concerns voiced below and with additional transparency.

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<sup>2</sup> On February 26, 2013, the CAT participants published a request for proposal (“RFP”) soliciting Bids from parties interested in serving as the plan processor. See Appendix A for the Consolidated Audit Trail National Market System Plan Request for Proposal (issued Feb. 26, 2013, version 3.0 updated Mar. 4, 2014). On September 30, 2014, the CAT participants published their [original CAT NMS Plan](#), providing the following estimated costs: (1) A range of **build costs** from about \$ 30 million to \$92 million, with an average of \$53 million (See [Appendix C, Page 54](#): “the six shortlisted bidders provided estimates ranging from a low of \$30,000,000 to a high of \$91,623,000, with an average one-time cost of \$53,002,915.27.”); and (2) a range of **5-year operating costs** from \$135 million to \$465 million, with an average \$255 million, or \$51 annually spread over five years (See [Appendix C, Page 54](#): “the six shortlisted bidders provided estimates ranging from a low of \$135,001,250 to \$465,050,000 over the course of the first five years of operation, with an average five-year cost of \$255,640,125.02, with an average annual cost of \$51,128,025.00.”).

- B. A reissuance of a full accounting of the historical spend, including an assessment of the management of the project, and a post-mortem review to guide us in any future projects. This accounting would be consistent with what might be expected in any commercial effort, especially in the case where a project is excessively over-budget and over-deadline. Technical expertise from the industry should be brought to bear in this analysis.
- C. A full explanation of the proposed operating costs should make an appropriate public disclosure of this to justify the impact on the industry. Technical expertise from the industry should be involved so as to ensure that CAT is built and operated as a best-of-breed solution.

### **III. Summary of Key Areas and Guiding Principles for Transparency.**

The following is a summary of what we would hope would be guiding principles for the Proposed Funding Model for which clarification, data, and transparency should be provided.

#### **A. Need for Greater Transparency on Historical Costs and on Production Budget**

MMI urges that there be greater transparency in the budget, including the data on numbers used to arrive at these fees and structure; why the build cost went multiple times above the original budget. Of note:

- 1. Greater transparency is sought on the high cost of the CAT build, and justification for why brokers should bear that cost. Brokers had no authority in that process; were not consulted on the infrastructure decisions; and had no disclosure or insight as to the build budget or costs. The \$242 million in Historical Costs cited in the Proposed Funding Model are roughly five times greater than the highest original estimates.<sup>3</sup> Based on comparable private endeavors, we have ample reason to question the high costs of CAT.
- 2. Brokers seek a full explanation for why they should be burdened with any of the \$90 million written off during the Thesys era, per the CAT LLC audited financial statements of 2019.<sup>4</sup> Of note, the Proposed Funding Model references a \$48 million accommodation without further explanation.
- 3. All of this raises questions of whether the original cost-benefit analysis of the CAT (mandated by regulations) is still valid. At market price with further competition in pricing and vendors, and with proper technical guidance and design, the CAT could reasonably be built and operated for far less.

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<sup>3</sup> *Id.*

<sup>4</sup> "The Historical CAT Assessment Costs would include costs incurred during the period in which Thesys CAT, LLC was the Plan Processor for the CAT, which was April 6, 2017 through March 28, 2019. The total costs for this period are \$106,256,258. The Participants, however, have determined to exclude from the Historical CAT Assessment Costs all costs incurred from November 15, 2017 through November 15, 2018 ("Excluded Costs") due to the delay in the reporting to the CAT. The Excluded Costs are \$48,874,937. Accordingly, the total costs for this period are \$57,381,321. The Historical CAT Assessment would be designed to recover 75% of these total costs, which is \$43,035,991." See "[Joint Industry Plan; Notice of Filing of Amendment to the National Market System Plan Governing the Consolidated Audit Trail](#)." 86 FR 21050; Release No. 34-91555 File No. 4-698; 2021-08049 (April 21, 2021).

Further, MMI urges greater transparency in the operating budget. Of note, no budget has been published. The Proposed Funding Model alludes to a CAT operating budget of \$150 million a year, which is extremely expensive, and several times higher than the highest original estimates.<sup>5</sup> No data or information has been provided to clarify or justify the large operating cost.

**B. Need for Greater Transparency on Ongoing Budget**

MMI urges greater transparency in the operating budget and the cost allocation model proposed. Of note:

1. The Proposed Funding Model alludes to a CAT operating budget of \$150 million a year, which is extremely expensive, and several times higher than the highest original estimates.<sup>6</sup> No data or information has been provided to clarify or justify the large operating cost.
2. Again, based on comparable private endeavors, brokers have ample reason to question the high operating costs.
3. There is a need for transparency on fixed costs (infrastructure, payroll) vs variable costs (messaging). The assumption that CAT costs should be apportioned according to “message count” should be supported with further data.
4. In order to analyze the “fairness” of the Proposed Funding Model, there is a need for transparency on the variable costs in CAT especially the “message count” input by product type – displayed, non-displayed, exchange traffic versus off exchange traffic; and Account Type - how much is Market Maker, Retail, Institutional, Professional, etc? How much of the data captured by CAT is submitted by exchanges vs brokers and ATSS? How much of the broker-submitted data is duplicative, not providing new regulatory insight, but only used to create “linkage” comparisons between parties?
5. Greater transparency is needed on definitions of various industry member allocations going into the budget – e.g., Page 23 – When the CAT Committee says in the Proposed Funding Model that it considered certain alternatives, what data did they consider, and how did that analysis indicate that the alternatives were less appropriate than the one proposed?

**C. Concerns About Lack of Transparency on Brokers Verses Exchanges Allocation (75-25)**

MMI respectfully raises the question regarding whether an inherent conflict of interest exists in plan participants determining the 75%/25% cost allocation without any collaboration with broker-dealers. No justification or reasoning is provided for this seemingly arbitrary split; and it provides little

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<sup>5</sup> See footnote 2.

<sup>6</sup> See footnote 2.

incentive for the SROs to justify Historical Costs or to manage a reasonable and efficient operating budget.

MMI believes that a more appropriate model would create some degree of “checks and balances.” The fee could work the same way as to the established precedent of Section 31 fees, whereby 100% or most of the CAT cost should be assigned to the SROs and then the SROs can make their own business decisions on whether and how to reallocate those costs to their respective marketplace participants. In fact, the Commission could simply increase the rate for Section 31 fees (we would recommend publicizing each component of it for transparency), and collection would be automatic, avoiding the need to manage billing and receivables for CAT.

Current market and regulatory structure creates a landscape which can incentive exchange operators to create multiple exchanges at minimal cost. However, the inevitable fragmentation of liquidity that results fosters a practice of compelling participants to generate “many messages” per trade. Again, we urge here the Commission to address the issue of fairness where market participants are being required to shoulder the burden of cost for a market structure they did not create nor control. Transparency around data submitted to the CAT will be helpful in better understanding the distribution of CAT reportable events between on-exchange transactions, customer-to-broker, and broker-to-broker transactions, and the respective messages per trade.

The current CAT governance model, and the current fee proposal, give the SROs no reason to manage the costs of CAT. MMI’s proposal would create some competitive pressure for at least the exchanges, who are for-profit companies, to manage the CAT costs and budget; and pass through the expense if they so choose to. It is appropriate to that accountability and burden on the SROs charged with managing the 9-year CAT development. Further, the exchanges understand how liquidity is provided on each venue, and they can directly analyze and decide how to allocate costs among market participants on their own venues.

#### **D. Need for Further Transparency on Cost Allocation to Various Industry Participants**

MMI notes that it is important for there to be robust competition in the markets and among market participants. There are several areas in the fee proposal that invite an opportunity for further transparency and discussion, including:

1. Cost allocation methodology differences between exchanges and brokers in the funding model;
2. Entities that are #1 or #2 in message traffic get discounts, whereas other market participants must then pay a relative premium on message traffic;
3. A cap on the options portion is included, which appears to set an arbitrary cap, without explanation of the methodology of arriving at the cap;
4. Clarification on the market maker discount, including cost allocation data and projections on market makers vs non-market maker liquidity providers;
5. Further information regarding the level of cost-savings, if any, to FINRA associated with the retirement of OATS, as it relates to offsets, if any, for the cost associated with running the CAT. With a proposed TAF fee increase for members beginning in 2022, it would be helpful to have further data and transparency of the relative cost burden to FINRA of running OATs verses the CAT, as well as further information on the increased

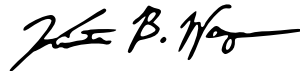
cost associated with membership. We hope that CAT will make regulatory function more, rather than less, efficient.

We believe that while the exchanges and FINRA have made an important next step (but not necessarily a step in the right direction) in proposing a cost allocation and funding model for the CAT, it is imperative that the above-mentioned questions and considerations be thoughtfully considered in putting forth a plan that takes into account the concerns raised by the industry.

MMI is pleased to continue to be a resource to the SEC as it works to ensure the safe, fair and orderly markets for investors through prudent regulation that instills investor confidence and fairness for all market participants.

Thank you for your consideration.

Very truly yours,

A handwritten signature in black ink, appearing to read "K. B. Wegner", with a stylized flourish at the end.

Kirsten Wegner  
Chief Executive Officer  
Modern Markets Initiative

cc: Mr. Michael Simon, CAT NMS Plan Operating Committee Chair